

# INDICATORS THAT CAN BE USED TO MEASURE PERFORMANCE IN THE INTERNAL AUDITING ACTIVITIES

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## **Abstract:**

*Internal auditing has evolved from an approach based essentially on accounting aspects to a profession oriented towards management of entities and essentially destined for them. Modern internal auditing provides services that incorporate the examination and appreciation of regulations, performances, risk management and governance of all kind of property types – public or private bodies. The financial aspects represent just a part of the internal auditing view. In this paper, we will try to submit a series of indicators that can be used to measure the added value generated in an entity. Internal auditors provide to managers the information they need in order to download their responsibilities. Internal auditors are vitally involved in aspects that address to the risks and governance of the organization.*

**Key words:** internal auditing, added value, performance, objectives, management

**JEL classification:** G34, M14

## **1. INTRODUCTION**

Generalized uncertainty, a phenomenon which today's managers are confronting with as part of their professional lives, makes impossible the anticipation of the way the business environment will evolve or what the consequences of their decisions will be. Worldwide, internal auditors practice their work differently, depending on the extent of the audit dictated by the management. Many auditors work under the direction of senior management, which may vary from the economic director to the general director. Others are directly subordinated to the audit committee of the management board. The audit committees are a key element of corporate governance, providing to management an independent assessment of the level of implementation of the risk management processes and internal control, of the quality of the financial results, of the internal audit and its correlation to the external audit. Through the results of the action taken, the audit committee allows the persons in charge with the corporate governance to estimate the quality of management and development perspectives of the organization.

Of course, not a single set of standards can tell managers how to use internal auditing. But in order to be seen by a third party as doing a professional activity, an internal audit job needs to demonstrate that it complies with standards, namely Standards on Internal Audit developed by The Institute of Internal Auditors (1). The leader of the internal audit function need to elaborate and update an insurance program and quality improvement that will cover all the aspects of the internal auditing activities and that will allow the constant surveillance of its effectiveness, thus covering:

- the way the internal auditing structures are organized
- the management of the internal auditing activity
- the planning activity of internal audit
- the code of compliance with methodology and procedures in the ongoing of internal audit missions, as well as the ethical code of conduct of internal audit
- the quality of the internal auditing reports
- the follow-up of the implementation of recommendations made in the audit reports
- organizing the reporting system of the internal auditing activity

The internal auditing standards contain the attribute standards, performance standards and implementation standards.

- attribute standards target the characteristics of organizations and persons which have internal auditing activities.
- performance standards describe the nature of the internal auditing activities and present quality criteria so these activities can be measured.
- attribute and performance standards are applied to internal auditing services in general.
- implementation standards apply; particularize attribute standards and performance ones to specific missions (for example a fraud investigation, a self –assessment project).

The most important result of these is that management needs to be sure that if the auditors report something, then it must be true, valid and objective. These attributes must never be compromised. Internal auditors are members of the management team and need to act like the manager. They needn't be part of any illegal or inappropriate activity. When such an activity is encountered, it must be reported to the organization's authorities.

Under the Ethical Code, internal auditors do not have the responsibility to report to third parties unless they are required by law to do so. Debatable cases need to be handled with care with the organization's legal department.

## **2. RESEARCH METHODOLOGY**

Research methodology can be assimilated to a structured and coherent system of rules, principles, methods, instruments and know-how for the sole reason that its basic elements are complementary and have effect only they are used in the right combination and effectively. The scientific research appears to be an interface between theory and practice. It is based on good theory, which it inspires from, borrows and used concepts, rules, procedures or instruments in order to know better reality, so search and find solutions, answers or explanations to theoretical or applied issues.

Scientific research methodology, which is at the foundation of this paper, is based on the fundamental type of research, which tries to make a survey of the main approaches, ideas and opinions of some specialists from the international published literature, also, seeking to offer a perspective upon the discussed issue. We have examined the opinions and information provided by the published literature and international standards of internal auditing using the descriptive method. We used the inductive method, as well as the deductive method. The final purpose of this research is so that we will be capable to draw a few relevant conclusions about the performance level in the internal auditing activity, from an approach from the international to the domestic, at the same time also identifying the factors that will influence the future evolution of internal audit.

Essentially, the real world is the beneficiary of the results of the research, but also it is a provider of the many issues it is called upon to solve. The real reference is the most important, maybe even the only one, if we were to admit that the theory, in its whole, formed as result of the need to solve specific problems and later to generalize. The pure deductive actions have maybe reached this level after a first stage of linking theory to reality through a few fundamental postulates that have become axioms through the fostering of an unanimous believe of their irrefutable validity and without proof.

Scientific research is basically never either pure perfect or perfect homogenate from a certain point of view. Only the intelligence, education or future experience of the researcher will manage the knowledge and the search.

## **3. THE ADDED VALUE OF INTERNAL AUDITING**

The recent definition of internal audit given by IIA includes the mention added value. One of the ways that internal auditors add value is by assuring that the results and recommendations which they present have a positive impact on the organization. Also they need to be sure that their contributions are understood and appreciated by the others. The results of the auditing may describe:

- actions that needed to be made, but were not made;
- forbidden actions;
- inappropriate actions;
- unsatisfying systems;
- risk exposures that need to be considered.

When we talk about internal auditing, it is hard to try and quantify the added value of the audited entity. Of course, we can consider as being added value the change of mentality of those being audited, the recommendations about the assessing of risks and reorganizing the management control system, but these are hard if not impossible to quantify. We can identify four factors that leave a significant mark on the added value of the internal auditors of the informational systems, and their organizations. (Roth, 2003):

- *A profound knowledge of the organization*, including its culture, key players in its activity, as well as *the competitive environment* in which it acts;
- *The courage to innovate* in such a way that the interested parties of the organization are not expecting;
- *A very good knowledge of the practices of the internal auditing profession*, in general, and of those about added value, especially;
- *Creativity manifested through innovation adaptation* to the organizations' conditions, obtaining favorable results, which can overcome expectations of the interested parties of the organization.

Internal audit needs to find the answer to the question: *Which is the most efficient method to evaluate added value?* The value that the internal auditing function adds to the entity means specific proceedings, criteria of measuring them. Roth J. has identified five characteristics which the ideal auditing department needs to fulfill, as its real provider of added value quality, thus:

- *The improvement of the personnel's experience in the auditing department*: implies that the organizations require more and more tangible added value, that needs to be quantifiable, as a result of the auditing activity, opposed to the value that some of the internal auditing profession initiators can offer;
- *A stimulating working environment*: this characteristic promoted the idea that *talented and motivated internal auditors*, from the internal auditing department, are more easily bored, and want work that can offer them challenges. That is why a special attention needs to be given to, *encouraging* and even to rewarding *constructive creativity* of the auditors, contributing in this way to the added value of the organization, in which that department works.
- *The alignment from a organizational point of view*: it means that some of those bigger auditing departments, which have two or more auditing managers, normally should align their organizational structure to the one of the bigger organization that it is part of;
- *Achieving a quality assessment of risks and on time*: auditors fulfill their objectives, if they consider to revise the management activity plan, but also have meetings and sittings with each and every executive manager, usually once a trimester, in order to always be informed about the evolution of the organization's strategies, as well as the eventual changes that might occur in the risk profile of the organization;
- *The matrix approach of the auditing services*: auditing departments, the real added value providers, have evolved from the "assessment function", to a more broad significance fulfilling gradually a "insurance and consulting" function, and offering, at the same time in the supplying of the traditional internal auditing work, a wide range of auditing services.

**Table no. 1. Quantitative performance indicators**

Indicator	Intent	Goal
1. Compliance to the initial planning	To measure <b>the realization degree of internal auditing activities</b> which are being done accordingly to the ones planned and approved by management.	To have a higher than 80% of the missions in the initial planning.
12. The time needed to do the audit	To determine <b>the length of time</b> spent on the auditing activity (auditing, special mandates and consulting services) for all the department activities.	To spend 80% or more of the days with auditing activities.
12. The length of time spent with the <b>special needs</b> of the auditing activity	To determine the importance the management gives to internal auditing function to some special needs.	To spend no more than <b>20%</b> of the time with special needs.
4. Implementing the recommendations (total or partial)	To determine the degree of fulfillment of the recommendations from the internal auditing reports.	To implement (all or some) 80% of the recommendations.
5. The length of time needed to implement the recommendations.	To measure the aim and feasibility of the internal auditing recommendations.	0 to 6 months (20%) 6 to 12 months (50%) 1 to 2 years (2%) 2 years or more (5%)
6. Potential material benefits of the recommendation.	To measure the monetary savings.	To have savings after at least 3 years (when it applies)
7. Cost per hour for the internal auditing work	To determine the cost per hour for the internal auditing work.	Under the market price.
8. The conformity to the time budget allocated to each mission	To determine the conformity with the time budget for each mission	100% (variation accepted up to 10%)
9. The conformity to the time budget allocated to each mission done	To determine the conformity with the period of time allocated for the sending of the project report to the clients.	100% (variation accepted up to five days)
10. Internal auditing resources	To determine the proportion in which the organization's resources serve the internal auditing function.	Sufficient resources depending on the size and nature of the organization
11. The length of time needed to finish the report project of the internal auditing	To assess the time spent from the ending of the auditing to the sending of the auditing report project to the clients.	Three weeks or less
12. Personal development	To assess the time allocated to professional development to insure the best quality of instruction of internal auditors	Between five and seven days per year per auditor.

Source :adaptation after Gagné Pierre, 2010

Another range of determinant factors in the added value providing is the one identified by Walz A.:

- *Efforts being made to increase the market value of organization;*

- *Reducing costs of the internal auditing function*, because every reduction of costs is seen as a determinant factor in the increasing of value;
- *Improving work productivity* and providing the same services with less resources (lower costs);
- *Adopting more efficient auditing techniques* through learning of some cutting-edge which will determine a higher added value;
- *Adopting some better auditing strategies*, through the redesign of the internal auditing plan in order to obtain a higher efficiency, if it is necessary and if in this way a better coverage of the auditing fields is being made with lower costs.

A few relevant guidelines that auditors need to consider, in order to be able to make recommendations that are real generators of added value (standard 2020 C1):

- *To consider the ways the audited organization creates value*, they need to be a supportive and not prevent it;
- *To promote the positive changes*. We can often see the case when the auditor's recommendations become value destructive because they have a view of "to do business as it is used to", seeking to maintain the existing practices and procedures;
- *To be future oriented*. A recommendation that prevents issues is much more valuable than one that corrects a current problem;
- *To be oriented towards the using of technological developing power*. Successful organizations win competitive advantages through applying of technology information systems.
- *To offer improvements that will help the organization to be more competitive in the field it activates*. The result of some of these recommendations take into account reducing of production costs, improving the production quality or improving the organization client's satisfaction.

We have identified twelve quantitative indicators in the published literature that measure the way the internal auditing function has an impact over the entity, over the internal management and over the obtained performances.

The question that may arise is "*how could audit contribute to the improvement of efficiency and effectiveness of risk management, control and processes of governance?*" In our opinion, a possible answer might be that internal auditing needs to analyze the organizations' operations and transactions, so it may be capable of identifying risks that can be generated from those transactions and operations, also being capable of identifying those controls that diminish those risks.

#### 4. CONCLUSION

The issue of measuring the performances of the internal auditing function acquires more and more significant meanings, and internal auditing needs to be capable of overcoming a significant challenge, in other words to find a method, the best and the most pertinent to measure performances and quantify the progress it has registered in the fulfillment of its aims and goals. Internal auditing needs to find the answer to the difficult question: Which evaluation and measurement method of performances is the most efficient and most relevant? We can propose ten universal business risks:

- wrong entries and/or information;
- unacceptable accounting principles;
- the business interruption;
- the changes in the legal department or illegal actions;
- high costs;
- foregone or lost revenues;
- the loss or destruction of assets;
- competitive disadvantages and/or public non-satisfaction;
- fraud or conflict of interest;

- inadequate management policies and/or decision processes.

In conclusion we can say that aspects that need to be considered are:

- Managers need to establish and communicate the value they want from internal audit and monitor results;
- Internal auditing need to convince directors, managers and administrators how they think they can provide added value;
- Internal auditors and managers need to find methods, objectives and measuring systems to demonstrate their value;
- Council directors need to declare what they think the role of internal auditing is and directors need to share information and exchange opinions with the sole purpose to appoint a common vision upon the major risks that influence the entity.

*Thus*, although the diversity that characterizes the conceptual approach of the added value, if the internal auditing function wants to truly extent its contribution, then: it needs to resolve this challenge to measure the added value and to show management that it can create real value from all the activities it involves.

#### ENDNOTES:

- (1) [www.theia.com](http://www.theia.com)

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